1-1-1987

Elimination of profits resulting from intercompany transfers of LIFO inventories; Practice bulletin, 02

American Institute of Certified Public Accountants. Accounting Standards Executive Committee

Practice Bulletin 2

November 1987

Elimination of Profits Resulting From Intercompany Transfers of LIFO Inventories

Accounting Standards Executive Committee

American Institute of Certified Public Accountants

AICPA

NOTICE TO READERS

Practice bulletins of the Accounting Standards Division are issued to disseminate the views of the Accounting Standards Executive Committee on narrow financial accounting and reporting issues. The issues dealt with are those that have not been and are not being considered by the Financial Accounting Standards Board or the Governmental Accounting Standards Board. Practice bulletins present the views on such issues of at least two-thirds of the members of the Accounting Standards Executive Committee, the senior technical body of the AICPA authorized to speak for the AICPA on financial accounting and reporting.

The Financial Accounting Standards Board and the Governmental Accounting Standards Board are the bodies authorized to establish enforceable standards under rule 203 of the AICPA Code of Professional Ethics. However, practice bulletins provide guidance on narrow issues that practitioners are encouraged to follow to enhance the quality and comparability of financial statements.

1211 Avenue of the Americas, New York, N.Y. 10036-8775

1 2 3 4 5 6 7 8 9 0 AccS 8987

Practice Bulletin 2

Elimination of Profits Resulting From Intercompany Transfers of LIFO Inventories

1. The Accounting Standards Executive Committee (AcSEC) believes it is desirable to issue a reminder concerning inventory transfers between or from LIFO (last in, first out) pools, either within a company or between subsidiaries or divisions of a reporting entity, particularly if a LIFO inventory liquidation has occurred in any transferring LIFO pool during the year.[1]

2. A LIFO liquidation (also called a decrement) occurs when the number of units (or total base year cost if dollar value LIFO is used) in a LIFO pool at year end is less than that at the beginning of the year, causing prior years' costs, rather than current year's costs, to be charged to current year's income. For example, in periods of rising prices, prior years' costs are less than current year's costs, and, in such periods, charging prior years' costs to current year's income results in reporting current year's net income higher than it would be reported without a liquidation.

3. Accounting for a LIFO liquidation is more complex with intercompany transfers of inventories. Accounting Research Bulletin (ARB) 51, states that "the purpose of consolidated financial statements is to present ... the results of operations and the financial position of the parent company and its subsidiaries essentially as if the group were a single company with one or more branches." Under ARB 51, intercompany profit on assets remaining within the group should be eliminated.[2] Results of operations and financial position, therefore, should not be affected solely because of inventory transfers within a reporting entity. Inventory

---

[1] This subject was identified in paragraph 3-2 of AcSEC's November 30, 1984, issues paper, *Identification and Discussion of Certain Financial Accounting and Reporting Issues Concerning LIFO Inventories.*

[2] APB Opinion 18, *The Equity Method of Accounting for Investments in Common Stock,* also requires elimination of a portion of intercompany profit.

transferred between or from LIFO pools may cause LIFO inventory liquidations, which could affect the amount of intercompany profit to be eliminated.

4. Many different approaches are used by entities in eliminating such profit. AcSEC believes that each reporting entity should adopt an approach that, if consistently applied, defers reporting intercompany profits from transfers within a reporting entity until such profits are realized by the reporting entity through dispositions outside the consolidated group. The approach should be suited to the entity's individual circumstances.

Accounting Standards Executive Committee
(1985–1986)

WALTER SCHUETZE
Chairman
G. MICHAEL CROOCH
DAVID W. DUSENDSCHON
JOHN W. HOYT
WAYNE A. KOLINS
JOHN L. KREISCHER
HOWARD B. LEVY
ALAN A. MCDONALD
CONLYN E. NOLAND, JR.
JOHN J. ROBBINS
RUDOLPH W. SCHATTKE
RICHARD B. SCHULTZ
JAMES O. STEPP
NORMAN N. STRAUSS
GLENN A. VAN NOORD

PAUL ROSENFIELD, *Director*
Accounting Standards

LIFO Inventory Problems Task Force

MICHAEL P. BOHAN
Chairman
JOSEPH V. ANANIA
GLENN BOUGIE
TIMOTHY M. COLLINS
RONALD F. HARNEK
ALLAN KORNFELD
CONLYN E. NOLAND, JR.
NORMAN N. STRAUSS
MICHAEL L. UNDERWOOD

JUDITH WEISS, *Technical Manager*
Accounting Standards

033112